October 4, 2021

Rule-comments@sec.gov

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F St, NE
Washington, DC 20549

Re: File No. S7-10-21

Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches, Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice (the "**Gamification Release**")

I. Introduction

The authors of this letter are partners with the law firm Wilson Sonsini Goodrich & Rosati, P.C. ("**WSGR**"). We submit this letter on our own behalf, and not on behalf of WSGR, or any of our Firm's colleagues or clients.

We both focus our practices on financial technology companies, and we help those companies develop novel financial services and products in full compliance with the federal securities laws and all other applicable financial services laws. We have both over many years represented a number of clients that have sought to use technology, including some of the technology described in the Gamification Release, to attempt to provide novel and superior financial services and financial outcomes to all segments of the trading markets, and in many cases specifically to retail investors who often do not, or who often appear to not, have the same access to financial services as do institutional and wealthy individual investors.

II. Comments

1. We note that commenters were given only 30 days to comment on the Gamification Release, which certainly left us, and may have left others, with inadequate time to address the many requests for comment raised by the Securities and Exchange Commission (the "**Commission**") in the Release.[1] Given the complexity of many of the issues the Commission

[1] In fact, we are submitting this letter one business day after the close of the comment period. The Staff informally advised us that they could not agree to accept letters filed after the official close of the comment period, and that only the Commission could provide such an extension. We hereby request the Commission to grant us the 1-business day extension to submit this comment letter.

has raised in the Release, and their close relationship to other complex issues – including market structure issues – we hope that the Commission will take its time in considering any proposed rule-making, and will give market participants far more opportunity for comment and other input into any proposed rule-making.

2. Many of the issues raised in the Gamification Release appear to raise concerns that are best addressed through appropriate disclosure (e.g., disclosure of the risks associated with entering into games and contests), and in egregious cases through application of the existing general anti-fraud and anti-manipulation rules of the applicable federal securities laws. It is unclear that any new rule-making is appropriate or necessary. An appropriate first step, perhaps, is for the Commission to propose and then, if appropriate after public comment and engagement, issue a principles-based statement of the types of "digital engagement practices," or "**DEPs**," that the Commission believes may require additional disclosure, and examples of circumstances under which the Commission thinks DEPs may raise anti-fraud or anti-manipulation concerns.

We also think that any rules specifically geared towards DEPs, as they exist today, would potentially become quickly outdated. The securities and financial technology communities are highly creative and their technology, products and services are constantly evolving. It is likely that any DEP-specific rules the Commission were to adopt today would be at best only marginally relevant to DEP practices in the not-too-distant future.

3. The Commission should support and encourage technological innovation in the securities markets, including the use of DEPs. Since at least the resolution of the back-office crisis in the 1960s, in significant part through the increased use of technology, the Commission and the US securities markets have consistently supported the use of technology to help the US maintain its role as the premier securities and capital formation markets in the world. We believe it would be a significant mistake for the Commission to take actions that would, perhaps for the first time ever, restrict the use of technology by financial service providers.

4. The Commission should support and encourage competition in the securities markets, including by removing unnecessary barriers to entry to new financial services providers that seek to provide financial services in new ways. It is easy and natural, but often counter-productive, to assume that new securities firms must do things the way that firms have done them in the past. Many securities firms (new and old) have found that DEPs are popular with investors, especially with younger investors who are familiar with DEPs outside of the securities industry. When practices are popular with the investing public (or at least with important segments of the investing public), the Commission should strive to help facilitate the use of those practices, consistent with anti-fraud, anti-manipulation, and similar investor protection concerns.

5. Many of the DEPs listed by the Commission in the Gamification Release appear to be positive developments. As just a few examples, the Commission's list of examples of DEPs includes:

* Social networking tools that enable users to access social sentiment. Social sentiment about a stock or a company can be valuable information for an investor, and is information that investors cannot obtain, for example, from required issuer filings with the

Commission. Social networking tools also can allow investors to share information and ideas with other investors (just as, for example, writers for financial publications and newsletters share their views and information with their readers). Subject to anti-fraud and anti-manipulation concerns, social networking tools – which are widely in use outside of the securities industry – should be facilitated by the Commission.

* Social network tools also can allow one user to post a portfolio, and allow other people to create copies of that portfolio. These types of social media tools can give investors new ideas and insights into portfolio construction and potential investment ideas, and they can give fledgling managers the opportunity to demonstrate their investment picking prowess. While these types of platforms can raise investment adviser and other regulatory considerations depending upon, for example, how people are compensated for posting their portfolios, there also is are important First Amendment considerations protecting the ability of a person to publicly disclose her portfolio if she chooses. Again, subject to anti-fraud and anti-manipulation concerns, the Commission should facilitate social media platforms that permit investors to share and follow investment ideas and portfolios.

* Games and contests, as well as other inducements, to encourage people to participate in the stock market are often educational, and often result in the presumably beneficial result of bringing more people into the securities markets. Games and contests typically are a form of advertising. They should be – and are – subject to the same anti-fraud and advertising rules as are other advertisements by securities professionals. There is no reason of which we are aware to apply additional regulatory requirements to these types of advertisements, and the Commission should be careful to not seek to regulate these activities simply because they are effective, and perhaps more effective, than conventional advertising. However, the Commission should not relegate securities firms to using advertising that was popular in the 1980s. The Commission's advertising rules – including the rules that govern games, contests, and the like – should be principles based rules designed to prevent fraud and manipulation, but should be flexible enough to allow securities firms to use novel methods of engagement to attract and retain customers.

* Notifications of trading opportunities, ideas, curated lists and the like are, in general, exactly what many people hire investment managers and brokers to provide to them. There also are numerous services and publications that provide trading signals and alerts to investors. Investors can choose whether to act on the notifications, but the notifications often provide valuable information and insights to traders. In any event, given how prevalent notifications are throughout the securities industry, it is not clear why the Commission might single them out in the context of DEPs. Quite the opposite, the Commission should encourage (again, subject to anti-fraud and anti-manipulation concerns) new methods of providing important market information to investors, and particularly to retail investors who may not have access to the same professional investment management and trading advice as do institutions and high-net-worth investors.

* Similarly, subscription services and tiered memberships are widely used throughout the securities industry (and outside of the industry). These allow financial services firms to offer a range of products and services, and to permit their customers to choose and

purchase the products and services they want. This seems to be an entirely reasonable, wide-spread and non-objectionable practice, which we believe the Commission should support.

* Stock trading simulations with fake money seem in general like an excellent way for investors to learn about investing in a safe and educational way, and seem like something the Commission should support. Similarly, visual cues that help investors more easily and intuitively understand the information being presented seem like something the Commission should support. In the same vein, the use of chatbots, which are widely used outside of the securities industry, to help investors with technical and other questions generally seem to be efficient and cost-effective methods of serving investors. These are additional practical and advantageous practices that the Commission should support.

* Celebrations of trading, such as confetti showing up on the screen after a trade, make trading fun, and enhance the user experience. Presumably, the Commission's concern is that if people have fun trading, they will trade more than they "should." Leaving aside how the Commission should determine how much any person "should" trade, it is difficult to believe that many people will place trades solely for the purpose of seeing pretty colors on their computer screen. Subject to legitimate anti-fraud and anti-manipulation concerns, making websites and other trading platforms fun to use, and not stodgy and boring, is a useful way of increasing investor education and engagement, and is the type of activity the Commission should encourage.

6. The Gamification Release in several cases seems to assume that frequent trading is inherently bad, and that DEPs inherently lead to more frequent trading by investors. Taking the second issue first, in our experience, many DEPs are part of platforms that in fact encourage relatively infrequent trading, and that seek to educate investors about when it is most advantageous to trade, and to not trade. In any event, however, it is not at all clear that frequent trading is inherently bad:

* The traditional concern about frequent trading has been that commission costs make such trading expensive and less likely to be profitable to individual investors as compared to buy and hold trading strategies. With the advent of brokerage firms that provide no-commission trading, this concern about frequent trading no longer is relevant. In this regard, practices like payment for order flow ("**PFOF**"), which help permit no-commission and low-commission trading, are potentially helpful to retail and other individual investors. A few observations on PFOF (especially since the Gamification Release refers to PFOF, arguably with a negative view about the practice):

** One of the principal concerns of the use of PFOF appears to be that brokers that receive significant PFOF do not get the same level of price improvement as brokers that do not receive PFOF. This seems entirely reasonable: a wholesaler in effect gives the broker a choice – receive PFOF and don't get as much price improvement, or don't get PFOF and get more price improvement. Brokers, in turn, then present their customers with a choice: pay no or a low commission and get less price improvement, or pay a higher commission and get more price improvement. At core, this is a disclosure issue; as long as investors are aware of the

inverse relationship (in general) between price improvement opportunities and commission rates, it is in the interest of investors to have the choice of how they want to pay for their trades.

** A significant issue here is the Commission's longstanding and unduly narrow conception of "best execution". Traditionally, the Commission and FINRA measure best execution solely by reference to the price at which a security is purchased or sold. From an investor's standpoint, however, that is only part of the cost-based analysis of whether the investor received best execution. The investor cares about the cost of the security plus the commission (or the mark up or mark down).

** So, consider two investors, each of whom buy 100 shares of ABC stock. Investor 1 buys the stock at $9.99 per share, and pays a $25 commission on the trade, for a total cost of $1,024. Investor 2 pays $10 per share (she did not get as much price improvement), but pays no commission, for a total cost of $1,000. Investor 2 paid less for the shares, even though she did not get the price improvement that Investor 1 got. Investor 2 is probably just fine with the fact that: (a) her broker received PFOF; and (b) Investor 1 got price improvement that she did not. Again, the key here is that both investors should get clear disclosure abut the inverse relationship between PFOF and commissions.

Notably, Investor 2 reasonably could decide to pay no commissions and get less price improvement even if there is a reasonable chance that she will pay more in total costs than would Investor 1. For some investors, paying no commissions is more important than the chance that price improvement will pay for the commission costs. For some investors, the opportunity for price improvement is worth paying the commission costs. This choice should be left to the investors, and the Commission's focus should be on making sure investors get adequate disclosure to responsibly make that choice.

** For an investor who would like to make frequent trades, having the option of a non-commission or low-commission broker is important. More generally, the Commission should encourage competition and a diverse set of trading options for investors, and should not unnecessarily restrict or prohibit practices like PFOF that give brokerage firms the ability to offer different trading options for investors.

* A second concern about frequent trading is that investors have to pay taxes on the gains, and may not be eligible for long-term capital gains treatment. This is hardly a reason for the Commission to disfavor frequent trading. If the investor has taxable gains, the investor can use some of the money from those gains to pay the taxes. If the investor has to pay higher marginal tax rates on gains from frequent trading than she would if she engaged in a long-term buy-and-hold strategy, that is part of the investor's investment strategy, and one that an investor can and should make for herself; it is not the Commission's role to make tax planning decisions for investors.

* We also note that today many investors -- including institutional, high net worth, and retail investors – engage in various forms of frequent trading activities (including high frequency trading and day trading activities), outside of platforms that employ DEPs. In the interest of creating and maintaining a "level regulatory playing field," if the Commission is

concerned about frequent trading, it should regulate that practice in all its forms and on all platforms, and should not use the possibility of frequent trading as the basis for regulating DEPs and DEPs alone.

7. The Gamification Release asks a number of questions about the use of artificial intelligence ("**AI**") in the securities industry. In our practice, we have seen clients use AI to, among other things, help with stock selection by private funds, by investment advisers (including robo-advisers), and by others. In our view, the Commission should support the responsible use of AI by securities markets participants.

AI offers the securities industry the ability to potentially offer what in some senses is the "holy grail" of investment advice and stock recommendations: advice and recommendations that are precisely tailored to each particular investor based on her unique financial situation, investment objectives and goals, investment preferences, ESG concerns, and similar individual preferences. AI can track and make investment recommendations, for example, based on when an investor has bought a house or sent a child to college, based on which businesses and social causes the investor supports, and based on when the investor has excess cash and when the investor has significant bills to pay and has less investible income. And investors can get the benefit of these AI insights and recommendations without having to affirmatively call a broker or adviser to update their financial information (which many people probably do too infrequently, if at all), and without having to go online and manually update that information (which many people probably rarely do).

AI, both in and outside the securities industry, and both in connection with and independent of DEPs, poses important privacy, data protection and similar considerations. The Commission's privacy regulations already are applicable to securities firms that use AI, and there is no apparent reason why different rules are needed for securities firms that use both AI and DEPs.

8. The Gamification Release asks various questions about the use of technology to provide investment advice by robo-advisers. For example, the Release (page 51) suggests that robo-advisers may rely on automated algorithms that:

> may produce investment advice for a particular client that is inconsistent with the client's investment strategy or relies on incomplete information about the client that depends on limited input data. Increased reliance on automated investment advice may result in too much importance being placed on clients' responses to account opening questionnaires and other forms of automated client evaluation, which may not permit nuanced answers or determine when additional clarification or information could be necessary. This reliance may also result in a failure to detect changes in clients' circumstances that may warrant a change in investment strategy.

These concerns, we think, stem from a misunderstanding of how many robo-advisers operate and are regulated. Most robo-advisers rely on Rule 3a-4 under the Investment Company Act of 1940 (the "**1940 Act**"). That Rule addresses how an investment adviser, including a robo-

adviser, that provides similar portfolio advice to many clients avoids being deemed to be running a fund that must be registered under the 1940 Act. Among other things, Rule 3a-4 requires that an investment adviser remind its clients at least quarterly to update their investment profile and information as necessary, requires the investment adviser to contact the client at least annually to determine whether any updates are necessary, and requires the investment adviser to give clients the ability to impose reasonable restrictions on the management of the client's portfolio.

These and similar provisions of Rule 3a-4 are intended to prevent advisers, including robo-advisers, from placing undue reliance on account opening questionnaires, and are intended to facilitate advisers, including robo-advisers, detecting changes in clients' circumstances that may warrant a change in investment strategy.

We also note that Rule 3a-4 requires advisers to offer clients the ability to impose reasonable restrictions on the management of their account, which presumably is at least similar to the Commission's concern about giving clients the ability to provide "nuanced answers." Also, as a practical matter, many investment advisers, and especially larger advisers with hundreds or thousands of clients, almost by necessity manage accounts with similar investment objectives similarly; for the most part, nuanced differences in how different clients answer the questions from advisers probably do not alter how the accounts of those clients are managed.

More generally, some of the discussion about robo-advisers arguably are based on the premise that a human being will provide better financial services and advice than will a computer. We do not think this is necessarily a valid assumption. In many fields of human endeavor, computers today perform services and perform computational tasks more efficiently than humans can. If computers can, for example, routinely win chess matches against the world's best chess players, why would the Commission assume that computers cannot also provide high-level investment advice and recommendations?

Robo-advisers also in many cases may be able to provide professional investment management services to retail and other investors who are underserved by more conventional advisers, and robo-advisers may be able to charge lower fees and require lower investment minimums than many conventional advisers. The Commission should, in our view, look for ways to facilitate the ability of robo-advisers to provide these important services, especially to underserved financial communities.

The Commission, quite appropriately, raises concerns about the need for sponsors of robo-advisers and other algorithmic trading platforms (including those using AI) to periodically review and as appropriate modify the operation of their algorithms. We agree. A separate question is whether any new rules actually are required to address this type of issue, or whether the Commission's (and FINRA's) existing rules already adequately address this concern.

We believe, for example, that the requirement for an adviser to monitor the performance of its computer algorithms is in many respects not materially different in concept from the obligation of an adviser to monitor and supervise human beings who provide investment advice. Human beings can suffer from many of the potential failings the Commission attributes to some robo-advisers – excessive reliance on account opening information, failure to update information

as client circumstances change, and failure to permit clients to impose reasonable restrictions on the management of their account. Humans, like computer algorithms, may over time provide sub-optimal management of their accounts, and may need training or coaching to improve their management of those accounts. We believe that the current regulatory framework that requires advisers to supervise their human employees is equally applicable to robo-advisers, and requires robo-advisers to appropriately supervise the performance of their trading algorithms.

We therefore urge the Commission to avoid adopting rules or positions that would unnecessarily limit or restrict the ability of robo-advisers and other algorithmic trading advisers to operate, and to compete on a level regulatory playing field with traditional investment advisory firms.

9. We applaud the Commission's request for comments on how to modernize the internet-only adviser registration exemption. In our practices, we have represented a number of advisers that rely on the internet-only exemption, and we have represented a number of others that arguably should be able to register with the Commission based on the concerns underlying that exemption, but that are technically not able to meet the requirements of that exemption.

The internet-only exemption requires, in substance, that all of an adviser's investment advice is provided through electronic means. The basis for the exemption is that an adviser providing advice electronically can reach a national investor base, which means that state by state regulation for such an adviser is impractical.

A key issue with the exemption is its absolute nature. For example, if an adviser advises 100 clients, and does so only through the internet, that adviser can rely on the internet-only exemption and register federally with the Commission. If another adviser advises 10,000 clients only through the internet, but advises another 25 by other means, that adviser cannot rely on the internet-only exemption, even though it reaches a far greater number of investors through its internet-only business.

The Commission should consider revising the internet-only exemption in two ways: (i) the exemption should be available to any investment adviser that provides investment advice solely through the internet to at least 51% of its customers; and (ii) the exemption should be available to any investment adviser that provides investment advice solely through the internet to 100 or more investors (the 100 person number is based, by analogy, on the separate exemption that permits an adviser to register with the Commission if it would be required to register in 15 or more states; usually, a state can require an adviser to register if the adviser has 6 or more human beings as clients in that state; this means that an adviser with as few as 90 clients (15 x 6) can register with the Commission under this multi-state exemption).

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We appreciate the opportunity to provide comments on the Gamification Release and would be happy to provide you with further information to the extent that you would find it helpful.

Respectfully submitted,

/s/ Robert H. Rosenblum

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